No. 14,834

IN THE

United States Court of Appeals

For the Ninth Circuit

In the Matter of
PETER COTTRELL SCOTT,
Appellant,
vs.
NORMA SMITH,
Appellee.

Appeal from the United States District Court for the Northern District of California, Southern Division.

APPELLANT'S OPENING BRIEF.

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STATEMENT OF THE CASE.

The appellant Peter Cottrell Scott was adjudged a bankrupt on December 18, 1953 (Transcript of Record page 5).* On June 15, 1954, Norma Smith, a creditor of bankrupt, filed her specifications of objections to discharge containing three grounds set forth in paragraphs 1(a) and 1(b), 2 and 3 (Tr. of Rec. 3-4). Upon hearing these objections, referee found the allegations of said paragraph 2 to be true and correct but did not find whether or not the allegations con-

*Hereinafter referred to as Tr. of Rec.

tained in paragraphs 1(a), 1(b) and 3 were true or correct or otherwise (Tr. of Rec. 35-36).

Upon such findings the referee concluded as a matter of law: (1) that the objection to appellant's discharge should be sustained on the grounds specified in said paragraph 2 and that the discharge in bankruptcy should be denied for the last mentioned reason (Tr. of Rec. 36-37) and made his order accordingly (Tr. of Rec. 37-38).

Bankrupt filed a petition for review of referee's order by judge in the United States District Court for the Northern District of California, Southern Division, specifying certain alleged errors particularly set forth therein (Tr. of Rec. 10-14). On May 10, 1955, the order, judgment and decree of the referee in bankruptcy was affirmed and the findings of fact made by the referee in bankruptcy were approved and adopted by the said Court as its findings of fact (Tr. of Rec. 39).

Appellant filed his notice of appeal to the United States Court of Appeals for the Ninth Circuit from the order of the United States District Court for the Northern District of California, Southern Division, June 8, 1955 (Tr. of Rec. 10), and his statement of points on appeal September 8, 1955 (Tr. of Rec. 88).

STATEMENT OF FACTS.

The evidence in this proceeding is that Norma Smith loaned the bankrupt and his then wife, Eliza-

beth A. Scott, $5,000.00 (Tr. of Rec. 45), after oral negotiations and an oral agreement to give a deed of trust on certain real property in San Jose (Tr. of Rec. 48). Norma Smith paid the $5,000.00 to the bankrupt by check in February, 1945 (Tr. of Rec. 57). The note was not then prepared but was prepared by the bankrupt (Tr. of Rec. 63) and several days after the $5,000.00 had been paid to the bankrupt and his then wife, the bankrupt gave the promissory note to Norma Smith in San Jose (Tr. of Rec. 57), which promissory note contained at the end thereof these words, "This note is secured by a Deed of Trust bearing even date herewith." (Tr. of Rec. 45). Norma Smith stated that she would not have loaned the bankrupt the money if she had known it had not been secured by a deed of trust (Tr. of Rec. 49). There was actually no deed of trust of even date with said promissory note (Tr. of Rec. 63). Although Norma Smith frequently visited the Scotts from 1945 to January, 1952, when the first Mrs. Scott died, she at no time discussed or inquired about the promissory note or the bankrupt's financial affairs even though the latter owed her $5,000.00 (Tr. of Rec. 58-59).

ARGUMENT ON SPECIFICATIONS OF ERROR.

I.

THE REFEREE ERRED IN CONCLUDING THAT THE WORDS, "THIS NOTE SECURED BY A DEED OF TRUST BEARING EVEN DATE HEREWITH" ON A PROMISSORY NOTE CONSTITUTED A FINANCIAL STATEMENT WITHIN THE MEANING OF SEC. 14 (c) (3) OF THE BANKRUPTCY ACT.

The above-mentioned section of the Bankruptcy Act (11 U.S.C.A. Section 32(c)(3)) provides:

> "(c) The Court shall grant the discharge unless satisfied that the bankrupt has (1) * * *; (2) * * *; or (3) obtained money or property on credit, by making or publishing or causing to be made or published in any manner whatsoever, a materially false statement in writing respecting his financial condition; or (4) * * *;"
>
> 11 U.S.C.A. 32.

Norma Smith, the objecting creditor, in paragraph 2 of her specification of objections to discharge, alleged that bankrupt had obtained money from her by making a materially false statement in writing respecting his financial condition (Certificate p. 18, line 23 to p. 19, line 2). In support of this allegation she testified at the hearing on her objections that she had loaned the bankrupt $5,000.00 and a few days later he had given her the promissory note offered and received in evidence in said hearing and set forth in full at pages 44-45 of the transcript of record. The last sentence of said note reads as follows:

> "This Note is secured by a Deed of Trust bearing even date herewith."

No other writing was offered or received in support of the allegations of said paragraph 2. It is in evidence and is conceded that no deed of trust was given to the objecting creditor by the bankrupt at the time of the delivery of said promissory note.

From this evidence the referee found and concluded that said last sentence was "a materially false written statement respecting the bankrupt's financial condition" and by reason thereof sustained the objecting creditor's objection to discharge and denied bankrupt's discharge (Certificate p. 20, lines 1 to 4 and lines 20 to 28).

In *Collier on Bankruptcy,* 14th Edition, page 1359, section 14.36, there appears the following statement:

> "Essential elements in general of 14(c)(3). Creditor alleging this objection must prove that the bankrupt:
>
> (1) obtained money or property on credit or an extension of credit;
>
> (2) that he did so on a materially *false statement respecting his financial condition;*
>
> (3) *that such statement was in writing;* and
>
> (4) that the statement was made or published by the bankrupt or someone duly authorized by him." (Emphasis added.)

In order therefore for the referee to reach his decision he had to find and conclude that the promissory note and particularly the last sentence thereof was "a false statement in writing respecting the bankrupt's financial condition". This we contend was in error for, as stated in *Collier on Bankruptcy,*

> "It was not the intention of Congress to extend clause (3)—14(c)(3) to all cases of false written statements where credit happens to have been given, but it should be confined to cases where the decision to give credit was induced by the false statement, which must have been, if not the moving cause behind the giving, extending, or renewal of credit, a contributing cause, i. e., the lender or seller must to an extent at least have relied upon it. Although it was formerly held that Clause (3) was not confined in its application to statements of general financial condition but covered any material statement of fact made in writing to induce the credit, *it is now limited in its application to statements respecting the bankrupt's financial condition.*" (Emphasis added.)
>
> *Collier on Bankruptcy,* 14th Edition, page 1365, section 14.39.

In the case of *In re Current,* 63 Fed. 2d 640 (CCA 7th Cir. 1933), Loring, a creditor, opposed bankrupt's petition for discharge on the same ground as urged in the case at bar, i.e., that the bankrupt had obtained credit or an extension thereof by a false written statement respecting his financial condition. The evidence in support of this objection was that Loring, to whom the bankrupt was indebted on a promissory note then due, presented to the bankrupt through Loring's bank a renewal note to be signed by the bankrupt and his brother. The bankrupt signed his own name and forged that of his brother. On this evidence the referee, like the referee here, reported the application for discharge unfavorably. The Dis-

trict Court sustained the creditor's objection and the bankrupt appealed to the Circuit Court, which reversed the lower Courts.

Judge Evans, speaking for the Circuit Court, said:

> "Did appellant '(bankrupt)' obtain an extension or renewal of credit, by making or publishing, or causing to be made or published, in any manner whatsoever, a materially false statement in writing respecting his financial condition when he * * * presented the forged note to Appellee? He obtained credit by making a materially false statement in writing when he caused to be presented to the loaner a forged promissory note. Was it, however, in respect to his financial condition?
>
> *"The presentation of a note apparently signed by a responsible third party, would, we think, hardly be in reference to bankrupt's financial condition, as that phrase is here used.* It is the representation that the bankrupt enjoys the backing of a responsible party, which fact indicates the existence of credit. However, *the phrase 'respecting his financial condition' limits and restricts the false* statement which may defeat the discharge. In short *the financial statement must be in respect to the bankrupt's financial condition.* * * *." (Emphasis added.)
>
> "Moreover subdivision (2) of this section '14b' used the same phrase 'financial condition' in such a way as to leave no doubt as to its meaning. Such being the fair interpretation of the statute, Courts are not at liberty to extend the meaning of the words to cover a particular case which might well have been included by Congress."

To paraphrase: the presentation of a promissory note apparently secured by a deed of trust would hardly be in reference to bankrupt's financial condition, as that phrase is used here. It is the representation that the bankrupt enjoys the backing of some property, but it does not indicate what property, the value thereof, nor what other or prior indebtedness may be against it. In short, the note in the case at bar, while a false statement in writing, is not a statement respecting Scott's financial condition.

In *Johnston v. Johnston,* 63 Fed. 2d 24, the bankrupt had forged his partner's name to a letter stating that he the bankrupt had authority to sign any papers in connection with the partnership business. When the bankrupt applied for a discharge his partner opposed his application urging the forged letter as a false written statement respecting the bankrupt's financial condition. From an order of the District Court granting the bankrupt a discharge, the former partner appealed.

Judge Parker of the Fourth Circuit, in affirming the order of the District Court, said:

> "The letter relied on was plainly not a statement respecting the financial condition of the bankrupt. It related neither to his financial condition nor to that of the partnership of which he was a member, but to his authority to act for the partnership. While its use was reprehensible, it cannot by any sort of interpretation be said to fall within the present language of the act. Even before the statute was amended (1926) not every fraudulent representation would bar discharge.

> Even the giving of worthless checks or mortgages on property not owned was held to come within its terms." (Citing cases.)

Judge Parker continued, quoting with approval from *Lockhart v. Edel,* 23 Fed. 2d 912:

> "Provisions of the section relating to a bankrupt's discharge are not to be extended by construction and the provisions as to discharge are to be construed liberally in favor of discharge."

In the case of *In re Schaeffer,* 68 Fed. 2d 902 (CCA 2d Cir. 1934), the bankrupt was denied a discharge when it was shown that he signed a note and conditional sales contract for an automobile which was purchased from the objecting creditor for delivery to a third party. The discharge was denied because of the claim that bankrupt had obtained property by a false statement.

The Circuit Court in reversing the District Court said:

> "The ground suggested for the denial of the discharge here is the obtaining of property upon a false statement. Such a statement must concern the financial condition of the bankrupt * * *."

An examination of the promissory note involved in this case in light of the foregoing authorities discloses that while the statement contained thereon is false it stops there. Nothing contained in the note and particularly in the last sentence refers to any particular property, real or personal, the value thereof, the rank or position of the supposed deed of trust, or

to any other financial matters pertaining to the bankrupt. How then can anyone reading this note determine any better the bankrupt's financial condition than he could determine how far is up? Obviously in neither instance is there given either beginning or end from which any determination may be made.

Since there is no direct and positive statement respecting bankrupt's financial condition contained in the note, can such a statement be inferred from the circumstances surrounding the making and from the statements contained in the note?

That question was presented in *Robinson v. Williston & Co.,* 266 Fed. 2d 970 (CCA 1st Cir. 1920). In that case the bankrupt Robinson had given a check to Williston & Co. for the purpose of obtaining credit from them. He had neither money or credit with the bank upon which the check was drawn and did not even have an account in that bank. His discharge was opposed on several grounds as in the present case and his application was denied, as also in the present case, on the grounds that the check constituted a materially false statement in writing. (Since this was prior to the 1926 amendment adding the words "respecting his financial condition" the latter words were not involved.)

Upon appeal to the Circuit Court, Johnson, the circuit judge, in reversing the District Court, said:

> "We agree * * * that a 'materially false statement in writing' * * * may include any 'materially false statement in writing' made by the bankrupt for the purpose of obtaining money or

> credit and by which money or credit is obtained; but we think such false statement should not be created alone from acts of the bankrupt." (pp. 971-972.)
>
> "Did the bankrupt in this case, by signing a check, which is simply a request to a bank to pay to the payee a certain sum of money upon its presentation, make any 'materially false statement in writing'? It is true that the check purports to be drawn upon a bank where the maker has funds or credit, and from his act in giving the check this may be inferred. If the bankrupt had made an oral statement at the time the check was given, that it was good, or would be paid when presented, or that his account was overdrawn, but that he had made arrangements with the bank on which it was drawn by which it would be paid, none of these oral statements would be a bar to his discharge.
>
> We think it was the evident design of Congress to confine the objecting creditor to the limits of a specific statement in writing made by the bankrupt, and that such a statement cannot be extended beyond the fair and necessary meaning." (p. 972.)

Following the reasoning and authority of the foregoing case (which has never been overruled or even limited), then no inference may legally be drawn to supply the missing details as to what property might have been referred to, its possible value, or the order or rank of the lien thereon. Neither may the oral statements of the bankrupt be resorted to to supply these deficiencies.

See, also:

In re Vamos, 14 Fed. Supp. 700.

The authority of the *Robinson* case is all the stronger in view of the fact that it was decided before amendment requiring the written statement to be "respecting his (the bankrupt's) financial condition".

In re Current, 63 Fed. 2d 640.

The objecting creditor, when before the referee, urged as authority for her contention that the promissory note here in question was a written statement respecting bankrupt's financial condition, the case of *In re Powell,* 22 Fed. 2d 239 (D.C. Md. 1927), in which a false chattel mortgage was held to bar a discharge. A reading of this case shows that giving of the mortgage, the adjudication and the application of the discharge all took place before the amendment of 1926 by which the present closing phrase of Section 14(c)(3) was added. The District Court in that case said:

> "Whether the substituting of the closing phrase 'respecting his financial condition' which is the only change pertinent to the present issue, for the words 'for the purpose of obtaining credit from such persons,' has the effect of narrowing the meaning of 'a materially false statement' we need not here decide, because the giving of the mortgage, the adjudication, and the application for discharge all antedate, and are not affected by, this latest amendment."

Thus it is clear that the Court decided only that a false chattel mortgage was a "false statement in

writing" and did not decide that such false chattel mortgage was "a false statement in writing respecting his (the bankrupt's) financial condition" as now required by the Bankruptcy Act.

The objecting creditor also urged before the referee that the written statement did not have to be a financial statement and in support thereof cited the following cases: *In re Weiner,* 103 Fed. 2d 421; *Albinak v. Kuhn,* 149 Fed. 2d 108; *Mau v. Sampsell,* 185 Fed. 2d 400, and *Yates v. Boteler,* 163 Fed. 2d 953.

It is conceded that the written statement does not have to be in the form of a financial statement, for the foregoing cases do contain such a holding, but they hold also that the content of such statements must be "respecting the bankrupt's financial condition."

In the *Weiner* case, above, the bankrupt had entered into an agreement in writing by which he obtained an extension of credit and represented that he had a valid promissory note against one Jed Harris which he assigned to Roeding, the objecting creditor. The bankrupt had no such promissory note, he being only an accommodation endorser thereon, and having a right thereunder only if he had paid.

The situation was somewhat similar in *Albinak v. Kuhn, supra.* The bankrupt, for the purpose of inducing a financial institution to part with its money and purchase certain purported accounts receivable, entered into a written agreement with the financial institution whereby he represented that he was solvent and that certain specified amounts were due on

accounts receivable from named customers and that there were not setoffs to said accounts and that the same had not been paid or transferred. Certain of the accounts receivable were shown to be nonexistent and an audit showed the bankrupt to have been insolvent at the time.

The circuit judge said:

> "* * * the assignments warrant and covenant that at their date the assignor '(bankrupt)' was solvent, and so, however persuasive may be the reasoning that a false statement of receivables is not a statement of financial condition, a warranty of solvency can be, and is nothing else. The representation of bankrupt's solvency was false * * *."

In *Mau v. Sampsell, supra,* the bankrupt owed the creditor a certain sum of money which was due and the creditor was demanding he be paid. The bankrupt wrote a letter stating that an existing escrow would net cash in excess of the debt, and requested, in effect, an extension of credit until the close of the escrow. The creditor withheld action upon the strength of the letter. No such escrow was in effect and upon bankrupt's application for discharge and the opposition thereto by the creditor, his discharge was denied upon the ground that the letter was a false statement respecting the bankrupt's financial condition. The Circuit Court affirmed without opinion.

In *Yates v. Boteler, supra,* there was actually a false financial statement given to Dun & Bradstreet by the bankrupt. The creditor did not actually see this report but relied on a letter report thereof given

to him by Dun & Bradstreet. While in that case the Court states that the form of the false statement is unimportant and cites *In re Powell,* above, it does not hold directly or by inference that a false chattel mortgage as such is a statement respecting financial condition, although it was urged before the referee that it did so hold.

An examination of these cases shows that in each case there was a specific reference to facts and particulars of property and amounts of money by which some computation of the financial condition of the bankrupt could be made or a statement that he was solvent, and there can be no question that the latter is a statement respecting financial condition.

As has already been pointed out, there was nothing in the promissory note from which the slightest idea of bankrupt's property, worth, liabilities or solvency could be computed or ascertained. It has also been shown that such lack cannot legally be supplied by inference. The findings and conclusions of the referee as to paragraph 2 of the specification of objections are therefore in error and should be reversed.

II.

NO EVIDENCE TO SUPPORT FINDING THAT NORMA SMITH, BY PURPORTED FALSE STATEMENT IN WRITING WAS INDUCED TO, AND IN RELIANCE THEREON DID, MAKE LOAN TO BANKRUPT.

In the event that it could possibly be held that the promissory note, and particularly the last sentence

thereof, was a "false statement in writing respecting his financial condition", the evidence does not support the referee's finding "that the bankrupt by said last mentioned words (This note is secured by a Deed of Trust bearing even date herewith, appearing on said promissory note) induced said Norma Scott (sic) to rely on the truth and correctness thereof and that she, so relying, made the aforesaid loan in the belief that said loan was to be, and was, secured by a Deed of Trust, as on said promissory note stated." (Tr. of Rec. 35).

The only evidence relating to the time of the payment of said $5,000.00 and the delivery of said promissory note as has been heretofore set forth shows that the money was paid to the bankrupt and his then wife and several days later, after the bankrupt had prepared the promissory note, the latter was delivered to Norma Smith. In other words, the loan was made first and the writing (which we do not concede was a financial statement) followed several days later (Tr. of Rec. 57-58).

Harold Remington, in his *Treatise on Bankruptcy,* 5th Edition, says, at page 599, "the extending of credit before the giving of the financial statement is insufficient" to bar a discharge.

In the case of *In re Woods,* 5 Fed. Supp. 901 (D.C. So. Dist. N.Y., June 19, 1933), the bankrupt applied for a discharge and a creditor filed objections specifying three grounds, the first being that bankrupt had obtained an extension of credit upon a false financial statement in writing.

Upon the hearing of the objections it appeared that bankrupt owed a bank $35,000.00 maturing January 22, 1931. On that date he paid the bank $2,500.00 and delivered a four-month note for $32,500.00. The bank took the cash but declined the note, demanded a financial statement, and in the meantime took a ten-day note. The bank found unsatisfactory the statement furnished and applied a bank deposit of bankrupt of $5,000.00 on the note. The bankrupt's attorney then offered to transfer certain property as collateral, which offer was considered by the bank. The ten-day note was about due so on February 3, 1931 bankrupt gave demand note for $27,500.00. A few days later the bank decided against any further extension and the following month brought suit.

The objections to bankrupt's discharge were discharged and his application for discharge granted. Peterson, district judge, said:

> "In my opinion the bank did not extend credit to the bankrupt upon the faith of the financial statement. The ten-day note was not taken in reliance upon the statement; *that note was received before the statement had been examined.* Nor was the later demand note of February 3rd taken in reliance on the statement. The bank had already indicated its dissatisfaction with the statement, and it took the demand note only as a provisional means while it was considering the proposal made for collateral security. Within a few days it rejected the proposal and demanded payment. Whether or not the statement was a false one, there was no credit extended on the faith of it, and the first specification fails." (Emphasis added.)

On appeal to the Circuit Court in *In re Woods,* 71 Fed. 2d 270, Swan, the circuit judge, said:

> "With respect to the first specification, relating to a financial statement given to a bank, it will suffice to say that the bank did not extend credit on the faith of the statement, and we can see nothing in the record which compels a reversal of that finding."

The Circuit Court reversed the order in the *Woods* case on other grounds.

In a recent case in the District Court for the Southern District of California, *In re Leonard,* 122 Fed. Supp. 214, objections were made to the bankrupt's discharge upon the ground that the bankrupt in order to obtain a loan from Pacific Finance Corporation, had made a statement in writing that his indebtedness did not exceed $1,217.55, when it was in fact $10,000.00. Upon the hearing a "witness came forth with a creditable statement which tended to corroborate the bankrupt's testimony that the loan had been consummated prior to the execution of the (written) statement and without reliance by the loan company upon either the statement or the supposed facts set forth in it."

Tolin, district judge, said, at page 218:

> "Whenever the giving of a false financial statement is urged as a ground for denial of a discharge in bankruptcy, to accomplish denial of discharge, it must be found that credit was obtained as a proximate result of the Statement, Morlon v. Snider, 20 Fed. 2d 469, 10 Amer. Bankr. Rep. NS 194. See also Bank of Monroe

v. Gleason, 8 Cir., 9 Fed. 2d 520, which holds that it is essential to show that a creditor relied on the false statement. Remington on Bankruptcy, Vol. 7, Fifth Edition, Sec. 3338, p. 601, 'Seventh Element, false statement must be relied on. The false statement must have been relied on, and if it was not relied on in parting with the property or in extending credit, the discharge will not be barred.' (Citing cases.)

The extension of credit must be after the giving of such a statement and in reliance on it. Such a conclusion in the case before us would only be possible by accepting answers to argumentively leading and suggestive questions put at a time when the witness disclaimed full memory and by rejecting testimony of the same witness when he testified after his memory was refreshed." (Emphasis added.)

There was a second ground of objection urged and the matter was rereferred to the referee to take evidence on the sceond ground, but the Court said:

"Unless that (the second) ground for denial of discharge be established, a discharge shall be granted to Wayne L. Leonard."

In the case at bar there is no dispute as to the time when the alleged statement was furnished. The objecting creditor herself testified that the money was paid to bankrupt and several days later the note was given her.

From the foregoing review of the evidence and the authorities applicable thereto, it is clear that there was not and could not have been any reliance upon

the promissory note and the statement thereon for the loan of the money, because the note was given to Norma Smith several days after the money was loaned. As already pointed out the law requires the objecting creditor to *rely* on a *written statement* of financial condition and unlike the statute of frauds a subsequent written memorandum of a previously unenforceable oral statement does not satisfy this requirement. Hence, there is no evidence to support the referee's finding in this respect.

III.

CONCLUSIONS OF LAW ERRONEOUS IN THAT THE SAME ARE BASED ON FINDINGS UNSUPPORTED BY EVIDENCE AND CONCLUSIONS UNSUPPORTED BY LAW.

As has heretofore been shown, the purported statement in writing, i.e., the promissory note, was not a "written statement respecting his (bankrupt's) financial condition". Furthermore, the money was not loaned in *reliance* upon the alleged written statement respecting bankrupt's financial condition. Both elements are indispensably necessary to bar a discharge.

> *Collier on Bankruptcy,* 14th Edition, page 1359, section 14.36.

It is quite clear then that the objecting creditor has shown neither of these necessary elements and has thus failed to show a reasonable ground, or in fact any ground, for the denial of the discharge.

> "The requirement that the objector show 'to the satisfaction of the Court' reasonable grounds for

believing that the bankrupt has committed an act which would be a ground for denying his discharge does not leave it to the whimsical or capricious judgment of the district judge or referee, but supplies a test or standard of persuasiveness which has a well accepted meaning in ordinary civil cases."

Collier on Bankruptcy, 14th Edition, page 1293, section 14.12.

Hence, since the referee's conclusions of law (Certificate p. 20, lines 20 to 28) the based upon findings unsupported by the evidence in this case, the same are therefore erroneous.

IV.

ORDER SUSTAINING OBJECTIONS AND DENYING DISCHARGE IS ERRONEOUS SINCE IT IS BASED ON ERRONEOUS FINDINGS OF FACT AND CONCLUSIONS OF LAW.

Since the necessary elements to bar a discharge have not been proved by the objecting creditor and are not in fact present in the case at bar and the findings of fact and conclusion of law are erroneus, as has been shown by the foregoing, the order of the referee is entirely erroneous.

CONCLUSION.

The promissory note, including the last sentence thereof, is not a financial statement respecting the financial condition of the bankrupt within the mean-

ing of the Bankruptcy Act, 14(c)(3) (11 U.S.C.A. Section 32(c)(3)); there was no reliance upon the alleged written statement, it having been delivered to the objecting creditor after the loan was made; the conclusions of law are erroneous, being based upon findings unsupported by either evidence or law; and the order based upon said erroneous findings and conclusions of law is in error. The order of the referee should therefore be reversed and this Court either order discharge of the bankrupt, or remand the case to the referee with directions to enter an order granting bankrupt his discharge.

Dated, San Jose, California,
January 3, 1956.

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